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IN THE

# Supreme Court of the United States

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OCTOBER TERM, 1972.

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IN THE MATTER OF
TIME SALES FINANCE CORPORATION.

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BLANK, ROME, KLAUS & COMISKY,
*Petitioner,*

*v.*

RAYMOND R. WALSH, TRUSTEE IN BANKRUPTCY,
*Respondent.*

---

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT.

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## BRIEF FOR RESPONDENT.

Respondent respectfully prays that the Supreme Court deny a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Third Circuit entered on April 26, 1973 (rehearing denied on May 16, 1973).

## QUESTION PRESENTED.

Is an attorney for a debtor corporation *not in possession* in an aborted proceeding for an arrangement under Chapter XI of the Bankruptcy Act entitled to compensation, as a matter of right, for services rendered in promulgating, and obtaining creditors' acceptance of, a plan of arrangement which was not confirmed by the Court because the debtor was guilty of an act barring its discharge under the provisions of the Bankruptcy Act?

## STATUTORY PROVISIONS INVOLVED.

1. Section 1(22) of the Bankruptcy Act, 11 U. S. C. § 1(22), which states:

> "The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows: . . . (22) 'Officer' shall include clerk, marshall, receiver, custodian, referee, and trustee, and the imposing of a duty upon, or the forbidding of an act by, any officer shall include his successor and any person authorized by law to perform the duties of such officer;"

Section 14c(6) and (7) of the Bankruptcy Act, 11 U. S. C. § 32c(6) and (7), which states:

> "c. The court shall grant the discharge unless satisfied that the bankrupt has . . . (6) in the course of a proceeding under this Act refused to obey any lawful order of, or to answer any material question approved by, the court; or (7) has failed to explain satisfactorily any losses of assets or deficiency of assets to meet his liabilities; . . ."

Section 64a(1) of the Bankruptcy Act, 11 U. S. C. § 104a(1), which states:

"(a) The debts to have priority . . . shall be (1) one reasonable attorney's fee, . . . to the bankrupt in voluntary and involuntary cases."

Section 246 (of Chapter X) of the Bankruptcy Act, 11 U. S. C. § 646, which states:

"Upon the dismissal of a proceeding under this chapter, or the entry of an order adjudging the debtor a bankrupt, the judge may allow reasonable compensation for services rendered . . . in such proceeding prior to such dismissal or order of adjudication by any persons entitled thereto . . ."

Section 302 (of Chapter XI) of the Bankruptcy Act, 11 U. S. C. § 702, which states:

"The provisions of Chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter . . ."

Section 342 (of Chapter XI) of the Bankruptcy Act, 11 U. S. C. § 742, which states:

"Where no receiver or trustee is appointed, the debtor shall continue in possession of his property and shall have all the title and exercise all the powers of a trustee appointed under this Act, . . ."

Section 366(2) and (3) (of Chapter XI) of the Bankruptcy Act, 11 U. S. C. § 766(2) and (3), which states:

"The court shall confirm an arrangement if satisfied that — . . . (2) it is for the best interests of the creditors and is feasible; (3) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; . . ."

## COUNTER-STATEMENT OF THE CASE.

Immediately upon the filing of the debtor corporation's petition for an arrangement under Chapter XI of the Bankruptcy Act, a receiver was appointed to operate and manage the debtor's business. The receiver, pursuant to authorization by the Court, retained counsel to represent him in the proceedings.

At a first meeting of creditors, the attorney for the receiver and the attorney for a creditors' committee sought to examine the president of the debtor corporation who was its operating head and, with his wife, the sole stockholder. Except for identifying his signatures on the schedules in bankruptcy and statement of affairs, the debtor's president refused to answer seventy-seven questions, which the Referee in Bankruptcy had approved as material. In answer to each question, the witness stated that on the advice of counsel he declined to answer on the ground that his answer might tend to incriminate him. In each instance the Referee sustained the constitutional privilege of the witness to refuse to answer.

An amended plan of arrangement was filed which provided a 40% distribution to unsecured creditors by way of preferred, non-voting stock in an unaffiliated finance company which was the proponent of the plan. The proposal was ultimately accepted by the requisite majority of creditors.

After a statutory hearing, the Referee entered his opinion and order denying confirmation of the plan. His denial was based on three grounds: (1) the proposed arrangement was not in the best interests of creditors because the refusal of debtor's president to answer material questions regarding debtor's assets and liabilities denied the Court the facts upon which it could predicate a judgment that the plan was for the best interests of creditors; (2) the refusal to answer

material questions approved by the Court constituted acts barring debtor's discharge and precluded confirmation of the plan under the provisions of Section 366(3) of the Bankruptcy Act, 11 U. S. C. § 766; and (3) the debtor's failure to make a satisfactory explanation of its loss or deficiency of assets to meet liabilities constituted yet another act barring its discharge. No review was taken from the Referee's order denying confirmation of the plan. Thereafter, an order was entered adjudicating the debtor a bankrupt.

Debtor's attorney (Petitioner herein) filed two applications for compensation: (1) a request for allowance of $10,000 as attorney for the debtor in Chapter XI, and (2) a request for allowance of $450 as counsel for the bankrupt subsequent to adjudication. The application for compensation as counsel for the debtor in Chapter XI was denied. The application as counsel for the bankrupt was allowed in the amount requested. (See Opinion and Order of the Honorable Emil F. Goldhaber, Referee in Bankruptcy, Appendix A.) On review the Order of the Referee was affirmed by the District Judge. (See Opinion and Order of the Honorable Thomas J. Clary, Senior District Judge, Appendix B.) On appeal the Order of the District Judge affirming the Order of the Referee was affirmed and rehearing denied. (See Orders of the Honorable Francis L. Van Dusen, Circuit Judge, Appendix C.)

## ARGUMENT.

### I. There Is No Reason Justifying Review.

The issue before the Court in the present case is limited to considerations involving the right of an attorney for the debtor in a proceeding under Chapter XI of the Bankruptcy Act to be compensated for his services out of estate funds. By no stretch of imagination can the issue be converted into a matter of constitutional application needing review by this Court.

The precise issue is whether an attorney for a debtor corporation *not in possession* is entitled to compensation in an aborted Chapter XI proceeding, as a matter of right, for services rendered solely in promulgating, and obtaining creditors' acceptance of, a plan of arrangement which could not be confirmed by the Court because the debtor was guilty of an act barring its discharge.

We respectfully submit that the matter is of little moment nationally, involves no grave questions of constitutional law, and is ill founded for consideration by the Supreme Court.

### II. The Decision of the Court Below Was Correct.

#### (a) Introduction.

The Referee's Order, affirmed by the District Judge and the Court of Appeals, denying compensation to the attorney for the debtor was based on two grounds:

> (1) There is no authorization in the Bankruptcy Act, and Congress did not intend to provide, for compensation to an attorney for a *debtor not in possession* under Chapter XI for services rendered in promulgat-

ing and obtaining acceptance by creditors of a plan of arrangement which is not confirmed by the Court.

(2) The attorney for the debtor, by advising the president of the debtor corporation to refuse to answer material questions under oath and thereby precluding confirmation of a plan, had no right to compensation for services rendered in promulgating and obtaining creditors' acceptance of the plan.

**(b) The Attorney for a Debtor Not in Possession Is Not Entitled to Compensation for Services Rendered in Promulgating and Obtaining Creditors' Acceptance of a Plan Which Is Not Confirmed.**

The Bankruptcy Court lacks power to grant compensation not expressly provided for in the Bankruptcy Act. *Robinson, Wolas & Hagen v. Gardner*, 433 F. 2d 1104 (9th Cir. 1970); *Guerin v. Weil, Gotshal & Manges*, 205 F. 2d 302 (2nd Cir. 1953); *Lane v. Haytian Corporation of America*, 117 F. 2d 216 (2nd Cir. 1941).

There is no provision in Chapter XI of the Bankruptcy Act, 11 U. S. C. § 301, for compensation to an attorney for a debtor in an aborted arrangement proceeding. Section 337(2), 11 U. S. C. § 737(2), deals with the deposit of money required prior to confirmation. One of the several items the debtor must provide for is ". . . the money necessary to pay the costs and expenses of the proceedings". There is no indication whatsoever with respect to what is encompassed within "costs and expenses of the proceedings". Nor is there any provision regarding the persons entitled to compensation in an aborted proceeding.

Section 302 of the Bankruptcy Act, 11 U. S. C. § 702, provides that the provisions of the first seven chapters of the Bankruptcy Act shall, insofar as they are not in conflict or inconsistent, apply to Chapter XI proceedings. The only authority for allowance of compensation to an attorney for

a debtor in an aborted arrangement is found in Section 64 of the Act, 11 U. S. C. § 104. *Klein v. Rancho Montana De Oro*, 263 F. 2d 764 (9th Cir. 1959); *In re Preston*, 89 F. Supp. 866 (S. D. N. Y. 1950).

Section 64, 11 U. S. C. § 104, provides that "(a) The debts to have priority . . . shall be (1) one reasonable attorney's fee, . . . to the bankrupt in voluntary and involuntary cases". The Supreme Court has defined allowances to the bankrupt's attorney out of the estate as services "rendered in aid of the administration of the estate and the carrying out of the provisions of the Act". *Conrad, Rubin & Lesser v. Pender*, 289 U. S. 472 (1933), 53 S. Ct. 703, 77 L. Ed. 1327. Those services are limited to the preparation of schedules, attendance at first meeting of creditors, and services in furtherance of winding up the proceedings. *In re Herald Post, Inc.*, 21 F. Supp. 231 (W. D. Ky. 1937); *In re Owl Drug Co.*, 16 F. Supp. 139 (D. C. Nev. 1936); *In re National Accessories, Inc.*, 13 F. Supp. 278 (D. C. Neb. 1936); *In re Evenod Perfumer, Inc.*, 4 F. Supp. 916 (S. D. N. Y. 1933); 3A Collier, *Bankruptcy* (14th Ed.) ¶ 62.31, pp. 1596-1611. The compensable services of a bankrupt's attorney have also been characterized as the preparation of schedules and performance of other statutory duties. *In re Kinnane Co.*, 242 Fed. 769 (6th Cir. 1917); *In re Fogarty*, 187 Fed. 773 (7th Cir. 1911); *In re Hughes Steel Erection Co.*, 231 F. Supp. 328 (E. D. Pa. 1964); *In re Geiser Mfg. Co.*, 23 F. Supp. 482 (M. D. Pa. 1938).

Petitioner acted as attorney for a debtor *not in possession*. During the Chapter XI proceeding the debtor's business was operated and managed by a receiver appointed by the District Court. The receiver was represented by counsel. Petitioner makes no claim for compensation based on services in aid of the administration of the Chapter XI proceeding. Indeed, Petitioner could

not be compensated for those services without an order of court authorizing such employment. *In re Hydrocarbon Chemicals, Inc.*, 411 F. 2d 203 (3rd Cir. 1969); cert. den. 396 U. S. 823 (1969).

There is no authority whatsoever to support Petitioner's contention that an attorney for a debtor *not in possession* is entitled to compensation for his work in promulgating a plan in an aborted arrangement proceeding. A review of the historical background of Chapter X reorganizations and Chapter XI arrangements indicates that Congress did not intend to authorize compensation to attorneys for debtors in unsuccessful arrangement proceedings for services in developing a plan which is not confirmed.

**(c) Congress Intended to Deny Compensation to a Debtor's Attorney for Services Rendered in Connection With a Plan of Arrangement Which Is Not Confirmed.**

Prior to the amendment to the Bankruptcy Act known as the Chandler Act of 1938, the Bankruptcy Court would not reimburse a debtor's attorney for services in an aborted reorganization under the since superseded Section 77B, 11 U. S. C. § 207, Act of June 7, 1934, Public Law No. 296, 48 Stat. 911. *In re Nine North Church Street, Inc.*, 89 F. 2d 13 (2nd Cir. 1937); *In re Geiser Mfg. Co.*, 23 F. Supp. 482 (M. D. Pa. 1938); *In re Higgin Mfg. Co.*, 19 F. Supp. 120 (E. D. Ky. 1937); *In re Manhattan Music Hall, Inc.*, 14 F. Supp. 48 (S. D. N. Y. 1936).

The same rule denying compensation governed in an aborted composition proceeding under the since superseded Section 74, 11 U. S. C. A. § 202, Act of March 3, 1933, Public Law No. 420, 47 Stat. 1467, and its predecessor Section 12, 11 U. S. C. A. § 30, Act of July 1, 1898, Public Law No. 171,

30 Stat. 544. *In re Kinnane Co.*, 242 Fed. 769 (6th Cir. 1917); *In re Fogarty*, 187 Fed. 733 (7th Cir. 1911); *In re Munford*, 255 Fed. 108 (E. D. N. C. 1919); 3A Collier, *Bankruptcy* (14th Ed.) ¶ 62.31, p. 1610.

Section 74(e), 11 U. S. C. A. § 202(e), was similar to the composition provisions of Section 12(b) of the old Bankruptcy Act of 1898, 11 U. S. C. A. § 30(b), which provided that after acceptance of the composition offer the debtor was required to deposit the money necessary to pay the "cost of the proceedings". This is quite similar to the present provision in Section 337(2) of Chapter XI, 11 U. S. C. § 737(2), which requires a deposit of the "money necessary to pay the costs and expenses of the proceedings", and which Petitioner contends is the statutory basis for the allowance sought by it in the instant case. The cases decided under the similar provisions in the prior composition sections of the Bankruptcy Act held, however, that legal services on behalf of the bankrupt in an aborted composition proceedings were not compensable in the ensuing liquidation. *In re Kinnane Co., supra; In re Fogarty, supra.*

The intent of Congress to deny compensation to the attorney for the debtor in an unsuccessful Chapter XI proceeding for services other than in aid of the administration of the estate is evident in the inclusion of Section 246, 11 U. S. C. § 646, in Chapter X of the Bankruptcy Act, by which the Court was expressly empowered to allow reasonable compensation to the attorney for the debtor in an aborted reorganization under Chapter X. Congress has not seen fit to give the Court the same power in unsuccessful Chapter XI proceedings. *Robinson, Wolas & Hagen v. Gardner*, 433 F. 2d 1104 (9th Cir. 1970); *In re Tariffville Manufacturing Company*, 253 F. Supp. 412 (D. C. Conn. 1965); *In re Dole Company*, 244 F. Supp. 751 (N. D. Me. 1965).

The opinions in these last three cited cases suggest that the Congressional intent was to discourage the bar

from resorting to Chapter XI in unpromising circumstances. The common knowledge on which the foregoing is based finds expression in Herzog, *Bankruptcy Tomorrow*, 45 Am. Bankr. L. J. 57 (1971), at 61:

> "Entirely too many debtors file Chapter XI petitions where there isn't the remotest possibility of achieving confirmation of an acceptable plan. Both they and their creditors would fare a lot better had they elected bankruptcy in the first instance."

The quoted words are those of the renowned Referee in Bankruptcy Asa S. Herzog, of the Southern District of New York, whose unreported opinion in *In re Styles Express, Inc.* (S. D. N. Y. 1971) (included in Petitioner's Appendix in the Court below) is heavily, but erroneously, relied upon by Petitioner. The Respondent does not assert or imply that the Petitioner in this case undertook to file an arrangement proceeding with little or no hope of success. On the contrary, the Respondent has every reason to believe that Petitioner undertook its employment in complete good faith. The point we make is that the many unpromising petitions that are filed under Chapter XI justify the conclusion that Congress did not intend to compensate counsel for a debtor *not in possession* in an aborted Chapter XI proceeding except for services "rendered in aid of the administration of the estate and the carrying out of the provisions of the Act." *Conrad, Rubin & Lesser v. Rubin, supra.*

**(d) The Refusal of Debtor's President to Answer Material Questions Upon Advice of Debtor's Attorney Precluded Confirmation of Debtor's Plan and Compensation to Debtor's Attorney for Services in Connection With the Plan.**

It has been previously noted, in Respondent's counterstatement of the case, that the Referee based his refusal

to confirm debtor's plan on three grounds: (1) the plan was not in the best interests of creditors because the refusal of debtor's president to answer material questions regarding debtor's financial affairs denied the Court the facts upon which it could predicate a judgment that the plan was for the best interests of creditors (Section 366(2), 11 U. S. C. § 766(2)); (2) the refusal to answer material questions approved by the Court constituted acts barring debtor's discharge (Section 14c(6), 11 U. S. C. § 32c(6)) and precluded confirmation of the plan (Section 366(3), 11 U. S. C. § 766(3)); and (3) the debtor's failure to make a satisfactory explanation of its loss or deficiency of assets to meet its liabilities constituted another act barring its discharge (Section 14c(7), 11 U. S. C. § 32c(7)).

The courts have upheld the denial of a bankrupt's discharge because of his failure to answer a material question approved by the court, which refusal is grounded on the bankrupt's claim of constitutional privilege. *In re Zaidins*, 287 F. 2d 401 (7th Cir. 1961); *Kaufman v. Hurwitz*, 176 F. 2d 210 (4th Cir. 1949); *In re Dresser*, 146 Fed. 383 (2nd Cir. 1906). The debtor took no review of the Referee's Order denying confirmation. It cannot be questioned at this time.

Petitioner contends that the Referee erred in concluding: (1) that its advice to debtor's president constituted a conflict of interest, and (2) that such advice rendered noncompensable all services which it had rendered "in aid of the administration of the estate" (See Petitioner's Brief, pp. 3, 13).

Respondent agrees with Petitioner that its advice to debtor's president did not involve a conflict of interest—but for a reason other than that advanced by Petitioner. The debtor's president was its sole stockholder (with his wife) and sole managing officer. Realistically, he was the

debtor. Thus, the advice given to him by Petitioner was advice given to the Debtor.

Consequently, we are squarely faced with the question whether Petitioner is entitled to compensation in an aborted Chapter XI for services rendered to the debtor in promulgating, and obtaining acceptance, of a plan when its advice to debtor to refuse to answer material questions under oath precluded confirmation of the plan. The question is most certainly *not* whether Petitioner's advice rendered non-compensable all services which it had rendered "in aid of the administration of the estate" (See Petitioner's Brief, pp. 3, 13). Petitioner is seeking compensation for legal services in connection with the promulgation and acceptance of debtor's plan. Those are not services "in aid of the administration of the estate". Those are services rendered for and in aid of the debtor; and the question is whether the now bankrupt estate should pay for those services when Petitioner's advice to debtor precluded confirmation of its plan.

It is appropriate to point out here that the Referee did allow compensation in the amount of $450 to Petitioner as attorney for the bankrupt. Presumably, this covered services rendered in the preparation of schedules and attendance at meetings before the Referee.

It has been held that a debtor's attorney was not entitled to an allowance for services rendered on behalf of a debtor in a composition proceeding under the old Section 12 of the Bankruptcy Act when a settlement approved by creditors was not confirmed by the Court because it was unjust in not maintaining the equality which the Bankruptcy Act contemplates. *In re Kinnane Co.*, 242 Fed. 769 (6th Cir. 1917). That holding is equivalent to the Referee's refusal to confirm in the instant case on the ground that the plan was not in the best interest of creditors. Section 366(2), 11 U. S. C. § 766(2).

More in point, it was held in another composition case decided under the old Section 12 that debtor's attorney was not entitled to compensation out of estate funds where a composition approved by the majority of creditors was not confirmed by the Court because the bankrupt had been guilty of an act barring his discharge. *In re Fogarty*, 187 Fed. 773 (7th Cir. 1911).

### (e) The *Robinson Case* Was Not Cited by the Referee for the Proposition Attacked by Petitioner.

The case of *Robinson, Wolas & Hagen v. Gardner*, 433 F. 2d 1104 (9th Cir. 1970) is discussed at length in Petitioner's brief. That case cited two grounds for its holding: (1) that the proviso in Section 337(2), 11 U. S. C. § 737(2), as it read prior to the amendment of 1967 under which *Robinson* was decided, precluded an allowance to debtor's attorney in an aborted proceeding; and (2) that Congress when it enacted the Chandler Act of 1938, amending the Bankruptcy Act, evidenced an intent to deny compensation to a debtor's attorney in an unsuccessful Chapter XI proceeding for services rendered to the debtor as distinguished from services rendered in aid of the administration of the estate.

Petitioner's entire argument is directed to the first ground. But that is not the ground relied upon by the Referee. The proposition cited by the Referee was based on the second ground. The Referee, in citing *Robinson*, states (see Opinion of Referee, Appendix A, at p. A4):

> ". . . The Court [in *Robinson*] points out that Congress must have intended compensation to be dependent on the success of the Plan of Arrangement from the fact that there are general compensation provisions in Chapter X and XII, which are omitted from Chapter XI. Hence, concludes the Court, 'the natural inference

is that Congress intended compensation in Chapter XI proceedings to depend upon the contingency of successful negotiation. It is not the function of this Court to frustrate Congressional policy.' "

The Court in *In re Casco Fashions, Inc.*, 346 F. Supp. 1252 (S. D. N. Y. 1972), and Referee Herzog in *In re Styles Express, Inc.* (unreported Referee's opinion S. D. N. Y. 1971, printed in full in Petitioner's Appendix in the Court below), in cases involving debtors *in possession*, were impelled to reject *Robinson* solely on the basis of the first ground without mention of the second ground.

**(f) The Discussion of Referee Herzog in Styles Express and the Court in Casco Fashions Is Not Relevant to the Case at Bar Because They Are Directed to Compensation of an Attorney for a Debtor in Possession as Distinguished From a Debtor Not in Possession.**

It offended Referee Herzog's sense of justice and fair play that an attorney for a *debtor in possession* would be denied compensation in an unsuccessful Chapter XI. Referee Herzog is quite right. A *debtor in possession* has all the title and exercises all the powers of a trustee. Section 342, 11 U. S. C. § 742. Bankruptcy General Order 44, 28 U. S. C., provides that no attorney for a receiver, trustee or *debtor in possession* shall be appointed except upon the order of the court. Bankruptcy General Order 42, 28 U. S. C., provides that no allowance of compensation shall be made to any attorney for a receiver, trustee or *debtor in possession* except for professional services. A *debtor in possession* by order of court under Chapter XI is an officer within the meaning of that term as defined in Section 1(22), 11 U. S. C. § 1(22). 1 Collier, *Bankruptcy* (14th

Ed.) ¶ 1.22, p. 139 (15. An attorney for a debtor in possession represents an officer of the court and performs the duties of an attorney for the receiver.

In the *Case of Jackson* and *State Express* cases, the attorneys for the debtors in possession did the work of an attorney for a receiver in the administration of the estate. In the case at bar the Petitioner makes no claim based on the kind of services rendered on behalf of a debtor. Its claim is based solely on services connected with the formulation and acceptance of a plan. In this connection the following comment by Referee Herman in *State Express* is pertinent (Petitioner's Appendix to the Court below):

> "I might agree with *Turnbull* (125 F. Supp. 45 (D. C. Conn. 1954)) to the extent that a prepetition attorney might be allowed to participate in the negotiation of a plan that was subsequently confirmed." (Italics ours.)

The opinion of the District Court in *State Express* also does not help Petitioner. It addresses the additional ground that the holding in *Jackson* would defeat the purpose of Congress in enacting Chapter XI which was to provide opportunity for reorganization and that there would be no incentive to attorneys if they had to participate in the main approval of the plan in reorganization proceedings and simultaneously realize upon the debtor's assets had it filed a Chapter X proceeding for reorganization which has no role under the Act in the

## III Conclusion

An attorney for a debtor in proceedings under Chapter XI proceeding is not entitled to compensation for services rendered in preparing and procuring acceptances of a